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In the Supreme Court of the United States

OCTOBER TERM, 1952

No. 489

ROLAND P. PLACE, *Petitioner*

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Sixth Circuit

---

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 100-109) are reported at 17 T.C. 199. The *per curiam* affirming order of the Court of Appeals (R. 117) is reported at 199 F. 2d 373.

JURISDICTION

The judgment of the Court of Appeals was entered on October 21, 1952. (R. 117.) The petition for a writ of certiorari was filed December 8, 1952. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254 (1).

QUESTION PRESENTED

Whether the court below erred in affirming the Tax Court's conclusion that taxpayer is not relieved of tax on the "rental" payments he made to his wife during the period January 1, 1942, to May 31, 1943, in excess of $3,400, or $200 a month, on the ground either (1) that the payments constituted his wife's share of the profits as a partner in his business or (2) that, as sole proprietor of the business, he is entitled to a rent deduction under Section 23 (a)(1)(A) of the Internal Revenue Code for the entire amount of the payments.

STATUTE INVOLVED

Internal Revenue Code:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) [As amended by Sec. 121 (a) of the Revenue Act of 1942, c. 619, 56 Stat. 798] *Expenses.*—
>
> (1) *Trade or business expenses.*—
>
> (A) *In general.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including * * * rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or

business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 23.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.
(26 U.S.C. 1946 ed., Sec. 181.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 3797.)

STATEMENT

Taxpayer claimed a deduction of $24,938.34 for 1942 and $30,406.74 for 1943 as rentals paid to his wife for the use of her property in a manufacturing concern owned and operated by him. The Commissioner determined that these sums were excessive to the extent they exceeded $2,400 for 1942 and $1,000 for 1943, or $200 a month for 1942 and the first five months of 1943, and that the excess was a gift. (R. 104.) The Tax Court sustained the Commissioner's determination and rejected taxpayer's alternative contention that his wife was a partner with him, sharing the profits of the business. (R. 105-109.) The Court of Appeals affirmed. (R. 117.)

The facts found by the Tax Court (R. 101-105) may be summarized as follows:

In 1922 taxpayer organized the Roland P. Place Company, a corporation engaged principally in the manufacture of "wheel truers". At the time of its incorporation, the Place Company purchased assets formerly owned by a company owned and operated by taxpayer and several others from 1919 to the time of its bankruptcy in 1921. The assets were purchased for $24,000 and included land, a plant built in 1919, machinery and equipment, furniture and fixtures, a truck, dies, patterns and drawings, and patents and licenses. (R. 101.)

The Place Company had been organized by taxpayer with funds supplied entirely by his wife. Of the 500 shares of original authorized capital stock, 498 shares were issued to the wife. The capital stock was increased in 1936, and taxpayer subscribed to the additional shares but never entirely paid for them. When the Place Company was dissolved on June 30, 1938, taxpaper owned 226 shares and his wife 498 shares. (R. 101-102.)

Upon the dissolution of the Place Company on June 30, 1938, assets having a book value of $5,246.86 were distributed to taxpayer and assets having a book value of $9,665 were distributed to his wife. The assets distributed to his wife consisted of the land, buildings, machinery, equipment, office furniture and fixtures, and an automobile. (R. 102.)

After the dissolution of the Place Company, the business was carried on by taxpayer as a sole proprietor until May 31, 1943. From the time taxpayer began operating as sole proprietor until January 1, 1942, he paid his wife a fixed rental of $200 a month for the use of the assets she received on dissolution. (R. 103.) Taxpayer thought this was the maximum rental he could afford at that time. The Place Company had had a net loss of $4,202.11 in the last six months it was in existence, and for the following six months, July 1 to December 31, 1938, the business resulted in a net profit of $5,385.76. (R. 103.)

Beginning in July 1939, taxpayer had the use of two machines loaned to him by Dow Chemical Company. One of these machines had been loaned since 1937. They were the only machines used by taxpayer in the manufacture of plastic cigarette cases, a product manufactured and sold since as early as 1938. In the latter part of 1942 he began selling them to an agent, who in turn supplied them to the United States Army. (R. 104.)

By May 1942 the business was prospering and taxpayer thought that his wife should receive more rental for the use of her property. Total receipts from the operation of the business during the years 1941, 1942 and the first five months of 1943 were $124,710.32, $237,926.43 and $151,176.87, respectively, resulting in net profits (after deducting the increased rentals in question) of $25,442.30, $30,480.19 and $37,163.81, respectively. (R. 103.)

On May 1, 1942, taxpayer entered into a written rental agreement with his wife. Taxpayer intended this agreement to be a lease and entered into it with the advice of counsel. The document embodying this agreement refers to it as a "lease". (R. 103.)

The agreement provided that taxpayer, as tenant, would rent and lease from his wife, as lessor, the assets received by the wife on dissolution, which included the land, buildings, machinery and equipment, and office furniture and fixtures, for a term from month to month at a rental equal

to 45 per cent of the net earnings of the sole proprietorship. Taxpayer originally planned to set the rate at 50 per cent of net earnings but, after further consideration, decided to retain an additional five per cent as compensation for his services. In addition, taxpayer agreed to keep the machinery and equipment in good repair, pay all taxes on the property, and protect it by adequate fire and tornado insurance payable to the lessor. The agreement, dated May 1, 1942, was made effective as of January 1, 1942. (R. 103-104.)

On June 2, 1943, pursuant to preliminary agreement entered into on May 31, 1943, by taxpayer and his wife jointly, the entire business of the Place Company was sold for $62,400.26. Taxpayer's wife received $52,323.06 of this sum for the land, buildings, machinery and equipment owned by her. The agreement also provided that taxpayer would be employed by the purchasing corporation at a salary of $10,000 a year, plus a certain percentage of profits. (R. 104.)

On the basis of the above facts, the Tax Court made the following ultimate finding of fact (R. 104-105):

> The maximum rentals petitioner was required to pay for the continued use and possession of the property rented from his wife was $2.400 in 1942 and $1,000 in 1943. * * *

ARGUMENT

As grounds for the granting of the writ, taxpayer asserts that the decision below (a *per curiam* affirmance on the Tax Court's findings of fact and conclusions of law (R. 117)) is in conflict with other decisions on certain points (Pet. 7-12). The alleged conflicts are non-existent. No adequate reason is presented for issuance of the writ.

1. The alleged conflicts with *Rupple* v. *Kuhl*, 177 F. 2d 823 (C.A. 7th), and *L. W. Tilden, Inc.* v. *Commissioner*, 192 F. 2d 704 (C.A. 5th), are based on taxpayer's erroneous assumptions (Pet. 7-9) that the Tax Court held that a joint venture cannot be created with respect to a continuing business and that certain attributes are necessary to create a joint venture or partnership.[1] What the Tax Court held was that taxpayer's alternative theory that he and his wife were joint venturers in the business during the period January 1, 1942, to May 31, 1943, "has no support in the record". (R. 109.) The reasons given by the Tax Court (*ibid.*) were that taxpayer submitted no evidence that the business was organized to carry out a specific venture or that it was in any way something other than a continuing business, no evidence that taxpayer and his wife had any in-

[1] Under Section 3797 of the Internal Revenue Code, *supra*, p. 3, a joint venture is treated as a partnership for tax purposes.

tention of becoming joint venturers, and no evidence of the normal attributes of a joint venture or partnership other than the sharing of profits (and that was under an agreement drafted and intended as a lease.)[2] The decision on this branch of the case is clearly correct and in no way in conflict with *Rupple* v. *Kuhl, supra,* or *L. W. Tilden, Inc.,* v. *Commissioner, supra,* in both of which there was evidence of an intent to create a joint venture.

2. With respect to the principle applied by the Tax Court—that, as sole proprietor of the business, taxpayer's right to rent deductions under Section 23 (a)(1)(A) of the Internal Revenue Code, *supra,* pp. 2-3, for the use of his wife's property in his business was limited to a reasonable allowance—taxpayer asserts a conflict both as to the applicability of the standard of reasonableness and as to the Tax Court's conclusion on the evidence. (Pet. 9-12.) Both assertions are without basis.

The alleged conflict as to the applicability of the standard of reasonableness is with the Tax Court's own decision in *Imerman* v. *Commissioner,* 7 T. C. 1030. In that case, as the Tax Court ex-

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[2] Taxpayer himself testified that he had rented the property from his wife after dissolution of the Place Company (R. 32) and that when he executed the May 1, 1942, lease "with the advice of counsel" it was his "intention at the time to make it a lease agreement" (R. 47).

plained in a subsequent decision (*Manos* v. *Commissioner*, decided November 30, 1949 (1949 P-H T.C. Memorandum Decisions, par. 49,278), affirmed, 187 F. 2d 734 (C.A. 6th)), the holding was that Section 23 (a)(1)(A) does not limit deductions for rental payments to a reasonable allowance where the rent is paid "as the result of an arm's length transaction" and there is no evidence that the payments were in fact gifts or the distribution of dividends. In the present case, there was no arm's length transaction. (R. 106.) Taxpayer's deduction for rental payments is accordingly limited to a reasonable allowance, as the Tax Court held. (R. 107.) See *Stanwick's, Inc.* v. *Commissioner*, 15 T. C. 556, affirmed *per curiam*, 190 F. 2d 84 (C.A. 4th); *Limericks, Inc.* v. *Commissioner*, 165 F. 2d 483 (C.A. 5th); *Hightower* v. *Commissioner*, 187 F. 2d 535 (C.A. 5th); *Palace Theatre* v. *United States*, 148 F. 2d 30 (C.A. 7th); *Manos* v. *Commissioner, supra*. The statute allows deduction only of rental payments "required to be made as a condition to the continued use or possession * * * of property". Hence, as the Tax Court held,

> When there is a close relationship between lessor and lessee and in addition there is no arm's length dealing between them, an inquiry into what constitutes reasonable rental is necessary to determine whether the sum paid is in excess of what the lessee would

have been required to pay if he had dealt at arm's length with a stranger. [R. 106.]

The alleged conflict with *A. & A. Tool & Supply Co.* v. *Commissioner,* 182 F. 2d 300 (C.A. 10th), is based on the Tax Court's refusal to accept taxpayer's testimony that the rent he paid his wife under the lease was reasonable in amount. In the *A. & A. Tool & Supply Co.* case it was held (p. 304) only that the Tax Court may not "arbitrarily discredit and disregard unimpeached, competent and relevant testimony of a taxpayer which is uncontradicted". Taxpayer's testimony that the rent was reasonable in amount was not "uncontradicted" testimony. It was contradicted, for example, by at least two very significant facts noted by the Tax Court (R. 106)—(1) that the approximately $25,000 paid under the lease for the 12 months in 1942 and the approximately $30,000 paid for the five months in 1943 were sums 10 to 30 times larger than the previously fixed rental of $200 a month, and (2) that the total of approximately $55,000 paid in the 17-month period was in excess of the price at which the property was sold in 1943, when, as taxpayer testified (R. 38), its value was higher than it was in 1942, the year in which the new leasing arrangement was instituted.

CONCLUSION

The decision below is correct and involves no conflict of decisions. The petition for a writ of certiorari should be denied.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1952

No. 489

ROLAND P. PLACE,
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vs.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

PETITIONER'S REPLY TO BRIEF FOR THE RESPONDENT IN OPPOSITION

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I.

JOINT VENTURES

(a) Conflict with Rupple v. Kuhl

Respondent suggests that the decision of the Tax Court in this case with respect to whether a joint venture properly exists in connection with a going business is not a decision of the Court on that point, but a statement of one of the reasons why the status of the parties was not that of joint venturers. Such an argument is invalid.

In this respect, the opinion is in conflict with the following cases:

Rupple v. Kuhl, supra;
Harvey Klein v. Commissioner, 18 T. C. (No. 98, decided July 25, 1952).

both of which cases are joint venture cases involving husband and wife, and in neither of which did the wife assume any losses or have any voice in the manner of conducting the business involved.

(c) Intent

The Court further held that there was no showing of any intent to become joint venturers, relying on the fact that the agreement was drafted in the form of a lease. If the agreement, with the same rights and obligations set forth in it had been drafted with appropriate language, labelling it a joint venture instead of a lease, the objection of the Court cited in the opinion would have been met.

The Court referred to the fact that petitioner admitted that he intended to enter into a lease agreement (R. 109) and referred to it as an admission of "absence of proper intent" (R. 109). Partnerships may grow out of relations in which the word "partnership" is not uttered (*N. B. Drew,* 12 T. C. 5). If, under the contract, there is such a joinder of interests and action as the law considers an equivalent of a partnership, or such as regards constituting a partnership, it will give to the persons engaged in it all the rights and lay upon them all of the responsibilities which belong to a partnership. See *Saward v. Saward,* 119 Misc. N. Y. 676; 197 N. Y. Supp. 123.

The decision of the Court casts a doubt on and creates confusion with respect to the principle of law that the intention of the parties is primarily to be determined from

the acts and obligations provided for in their written contract, and that substance prevails over form.

(d) The Question of Sharing of Profits in a Joint Venture When Paid for the Use of Property

In connection with the matter of the sharing of profits of the business, it is clear that the Court gave no weight to the sharing of profits in this case because they were paid to the wife as compensation for the use of her property and, therefore, labelled "Rent."

We contend that, with respect to the existence of a joint venture as distinguished from a partnership, even when received as compensation for the use of property used in the business, the participation in the profits of a business should be not only substantial evidence of, but a conclusive test of the existence of a joint venture.

Up to the year 1860 the rule in England and America was that participation in the profits of a business was a conclusive test of partnership, but this rule was overthrown by the decision in *Cox v. Hickman*, H. L. Cas., 268; 18 L. R. A. New Series, 966 (Anno.); *131 A. L. R.* 510, Anno.; *American Jurisprudence*, p. 147, Sec. 33.

131 A. L. R. 510, Anno;

Important exceptions to this rule have been introduced, and one of the exceptions is that the rule is not applied where the participant did not receive the profits as a "principal" or "as profits," or where the profits were received as payment for rent to a landlord. *40 American Jurisprudence*, 147, Sec. 33.

It may well be concluded that these exceptions are part of the common law in the United States as of today, with

respect to the existence of a partnership. However, these exceptions do not apply to the definition of a "syndicate, group, pool, joint venture, or other unincorporated organization," which recently have been added to the definition of a partnership for tax purposes by the Internal Revenue Code.

As stated in Regulation 111, Sec. 29.3797-4, (Partnerships) the Internal Revenue Code has *added* to the definition of a partnership certain relationships which are not included under the definition of a partnership at common law, including a "group, pool, joint venture, or other unincorporated association," which carries on any business, and is not with the exceptions specified in the code. In other words, the common law definition of a partnership has been broadened and other entities added which would not be covered by the common law definition.

We contend that the reasons for the elimination of the sharing of profits as a conclusive test for the existence of a partnership at common law are not applicable to groups, pools or joint ventures, under the Internal Revenue Code, and that with respect to such entities, the old test of the existence of a partnership still applies, namely, the sharing of the profits of the business. But the opinion of the Tax Court is tantamount to a holding that the written agreement of the parties to share the profits of the business and the carrying out of the agreement between them is to be given no weight in considering the existence of a joint venture under the code when such profits are paid for the use of property.

II.

DEDUCTIONS UNDER TITLE 26, SECTION 23 (a)(1)(A)

Respondent attempts to justify his contention that the decision in this case is not in conflict with the case of *Imerman v. Commissioner,* 7 T. C. 1030, for the alleged reason that the transaction here involved was not the result of an arm's length transaction, and, therefore, falls within the class of cases cited by the Tax Court in the *Imerman case* as exceptions to the rule that the "reasonable allowance" provision of the code does not apply to the provision for payment of compensation for the use and continued possession of property. Such a contention is not valid.

The case here involved does not fall within the line of cases which were excepted in the *Imerman case.* In this case there is no gift with reserved control; no domination of one party by another, as by a corporation over its subsidiary; nor is one party the alter ego of the other, and the properties held by them were held separately, and not in common, as in the case of *Limericks, Inc.,* 11 T. C. 1129, (affirmed 165 Fed. 2d, 483). In the excepted cases there was no *bona fide* separate ownership of the property as in the case at bar, for which the compensation was paid.

(a) Meaning of "Arm's Length" Transactions

In order to come within the rule of "arm's length transactions," both parties involved should be dominated by a common interest. *Inecto, Inc. v. Higgins,* (D. C. of N. Y.) 21 Fed. Supp. 418, 422. See also *Morgan Stanley & Company v. Security & Exchange Commission,* 126 Fed. (2d) 325, 330, 331, in which case the "arm's length transac-

tions" involved interference with competitive conditions through domination of one company by another, and in which it is pointed out that "arm's length" in its traditional sense relates to fiduciary relationships in which the "domination" necessary to involve the principle of such transactions exists because the control springs from the vesting of legal title of the property in the trustee.

We stress the fact that the wife in this case had control over the property here involved from the time of its acquisition in 1922 to the time of its sale in 1943, either through her majority holdings in Roland P. Place Company, or by taking title to the property on dissolution of the company.

Here there was no gift with retained control; no pre-transfer of property rights; no sham or juggling. The wife was the *bona fide* separate owner of the property and possessed control over the business through her legal right to have it removed from her property.

The parties had the legal right to conduct the business in any form they might choose for their best advantage taxwise. Had the parties made this arrangement while the company was struggling along, there could have been no objection to it. Because they delayed the readjustment of the wife's compensation until the business commenced to make money should not preclude their rights.

It is a very strange doctrine for the Court to hold that under such circumstances the parties were limited to their right of readjustment of the wife's compensation to an amount which would have been paid by a stranger. (See Court's opinion, R. 107).

CONCLUSION

We respectfully submit that to leave standing without review the conflicts created by this opinion and the doctrines therein enunciated will result in confusion and great mischief, and that it is of paramount national importance that the findings and opinion of the Court below be reviewed by this Court.

Respectfully submitted,

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January 16, 1953.

CERTIORARI DENIED